

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission
On its Own Motion

-vs-

Northern Illinois Gas Company
d/b/a Nicor Gas Company

Reconciliation of revenues collected
under gas adjustment charges with
actual costs prudently incurred.

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Docket No. 03-0703
On Rehearing

INITIAL BRIEF ON REHEARING OF THE STAFF
OF THE ILLINOIS COMMERCE COMMISSION

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Staff of the Illinois Commerce Commission (“Staff”), by and through its counsel, pursuant to Section 200.800 of the Rules of Practice (83 Ill. Adm. Code 200.800) of the Illinois Commerce Commission (“Commission”), respectfully submits its Initial Brief on Rehearing (“IB on Rehearing”) in the above-captioned matter.

I. INTRODUCTION

A. Procedural Background

On November 12, 2003 the Commission, pursuant to Section 9-220 of the Illinois Public Utilities Act (“PUA”) (220 ILCS 5/9-220), initiated a reconciliation of revenues collected under purchased gas adjustment (“PGA”) charges with actual prudently incurred costs for Northern Illinois Gas Company d/b/a Nicor Gas (“Nicor” or “Company” or “Nicor Gas”) for the period January 1, 2003 through December 31, 2003. (Initiating Order, Docket No. 03-0703, November 12, 2003)

On February 23, 2006, an initial status hearing was held at the Commission's Chicago office. The matter was continued generally due to other pending matters. (Tr. 3:21- 4:10, February 23, 2006.)

During the course of the proceeding, the following parties filed appearances or intervened in this matter: Staff, Nicor Gas, the Citizens Utility Board ("CUB"), and the People of the State of Illinois by Attorney General Lisa Madigan ("AG").

Staff filed testimony for the following witnesses: Mary H. Everson, Accountant (Direct, Staff Ex. 1.0 Rev and Rebuttal, Staff Ex. 3.0), Mark Maple, Engineer (Direct, Staff Ex. 2.0) and David Rearden, Ph.D., Economist (Staff Ex. 4.0 (Confidential and Public)).

Nicor Gas filed testimony for: Leonard Gilmore¹ (Revised Direct, Nicor Ex. 1.0R and Rebuttal, Nicor Ex. 4.0), Bob O. Buckles, (Direct, Nicor Ex. 2.0; Supplemental Direct, Nicor Ex. 3.0 and Rebuttal, Nicor Ex. 5.0), Timothy S. Sherwood, Surrebuttal Nicor Ex. 6.0, Christopher G. Gulick, Surrebuttal Nicor Ex. 7.0, and Sherman J. Elliott, Surrebuttal Nicor Ex. 8.0.²

CUB filed direct and rebuttal testimony by Mr. Jerome D. Mierzwa (CUB Ex. 1.0 and 2.0, respectively).

An evidentiary hearing was held on March 17, 2015 at the Commission's Chicago offices.³ The previously mentioned testimony of Staff, the Company and CUB was admitted into evidence along with certain Staff, Company and CUB cross exhibits. (Tr.

¹ Mr. Gilmore's testimony was subsequently adopted by Mr. Sherwood. (Tr. 34, March 17, 2015)

² Mr. Elliott's testimony was subject to a motion to strike filed by the CUB. Prior to the evidentiary hearing , the ALJ struck Mr. Elliott's surrebuttal testimony, Nicor Ex 8.0, plus attachments and portions of Mr. Sherwood's testimony which referred to Mr. Elliott's surrebuttal testimony.

³ Staff witness Dr. Rearden testified and was subject to cross examination by video conference from the Commission's Springfield office. (Tr., 159-161 and 162-204, March 17, 2015)

26-244, March 17, 2015.) At the conclusion of the evidentiary hearing, the ALJ continued the matter generally. (Id. at 243.)

Staff, Nicor and CUB-AG⁴ filed Initial Briefs (“IB”) and Reply Briefs (“RB”) on April 29, 2015 and May 27, 2015, respectively.

An ALJ’s proposed order (“ALJPO”) was served on the parties on July 7, 2015. Exceptions and Reply Exceptions were filed by CUB-AG and Staff on August 14, 2015. Reply Exceptions were filed by the Company August 28, 2015.

On September 16, 2015 the Commission voted on its final order in this matter.

On October 19, 2015 CUB filed an application for rehearing.

At a Commission Special Open Meeting on November 4, 2015, the Commission voted 3 to 1 to grant CUB’s application for rehearing. (November 4, 2015, Commission Special Open Meeting, Tr 3.)

A status hearing was held on December 2, 2015, at which time by mutual agreement of the parties, the due dates for the filing of simultaneous initial and reply briefs on rehearing were set at January 11, 2016 and January 20, 2016, respectively.

B. Scope of Rehearing

Staff, Nicor, CUB and AG agree that the scope of rehearing encompassed all that was set forth in the CUB application for rehearing. (Tr. 6:4-7, December 3, 2015.) The CUB application for rehearing was very broad. CUB requested that the Commission reconsider and rehear the proceeding. (CUB Application for Rehearing, 7.) In its application for rehearing, CUB alleged certain errors by the Commission. CUB alleged that the Commission:

⁴ CUB and the AG filed a joint brief.

- (1) ignored and arbitrarily rejected record evidence demonstrating the unreasonableness of Nicor's use of stored gas for third parties during the reconciliation year;
- (2) misapplied the prudence standard; and
- (3) erroneously accepted Nicor's claim that CUB and Staff's⁵ adjustments are based upon hindsight review.

(Id. at 1 and 6.)

C. Legal Standards

The legal standards for this rehearing are the same standards that applied in the original proceeding. As discussed in Staff's IB, the relevant statute is Section 9-220 of the PUA. Section 9-220 of the PUA provides that the Commission may authorize an increase or decrease in rates and charges based upon changes in the cost of purchased gas through the application of a purchased gas adjustment clause. Section 9-220(a) requires the Commission to initiate annual public hearings to:

determine whether the clauses reflect actual costs of fuel, gas, power, or coal transportation purchased to determine whether such purchases were prudent, and to reconcile any amounts collected with the actual costs of fuel, power, gas, or coal transportation prudently purchased. In each such proceeding, the burden of proof shall be upon the utility to establish the prudence of its cost of fuel, power, gas, or coal transportation purchases and costs. ...

(220 ILCS 5/9-220(a).)

The relevant Commission rules are found at 83 Ill. Adm. Code 525, "Uniform Purchased Gas Adjustment Clause" ("Part 525"). For gas purchases, the provisions of

⁵ While the CUB-AG Application for Rehearing does not specifically refer to Staff's adjustment, the portion off the final order which CUB-AG takes issue with indicates that the Commission found not just CUB's but also Staff's adjustment to be improper hindsight review.(CUB-AG Application for Rehearing, 6.)

Section 9-220 of the PUA are implemented by Part 525. Section 525.40 of Part 525 identifies gas costs that are recoverable through a PGA. Adjustments to gas costs through the Adjustment Factor are addressed in Section 525.50. The gas charge formula is contained in Section 525.60. Annual reconciliation procedures are described in Section 525.70.

The Commission has defined prudence as:

[...] that standard of care which a reasonable person would be expected to exercise under the circumstances encountered by utility management at the time decisions had to be made. In determining whether or not a judgment was prudently made, only those facts available at the time the judgment was exercised can be considered. Hindsight review is impermissible. Imprudence cannot be sustained by substituting one's judgment for that of another. The prudence standard recognizes that reasonable persons can have honest differences of opinion without one or the other necessarily being 'imprudent'.

(Order, Docket No. 84-0395, October 7, 1987, p. 17)

Also, in Docket No. 88-0142, the Commission defined prudence as follows:

Prudence is that standard of care which a reasonable person would be expected to exercise under the same circumstances encountered by utility management at the time decisions had to be made. In determining whether a judgment was prudently made, only those facts available at the time judgment was exercised can be considered. Hindsight review is impermissible.

(Order, Docket No. 88-0142, February 5, 1992, pp. 25-26)

In Section 9-220(a) proceedings, the burden of proof is on Nicor Gas to establish the prudence of its costs of gas purchases and related costs. (220 ILCS 5/9-220(a)). Nicor Gas has the burden to prove this by a preponderance of the evidence. (5 ILCS 100/10-15). Preponderance of the evidence has been defined as the evidence that is more probably true than not. (See, e.g., Witherell v. Weimer, 118 Ill. 2d, 321, 336, 515 N.E.2d 68 (1987)).

II. ARGUMENT

A. Dr. Rearden's first adjustment – "non-PGA Hub revenues"

Staff's first adjustment is based on Section 525.40 (d) of the Commission's rules. It is Staff's position that all Hub revenues must offset PGA costs, because the Hub uses assets whose costs are recovered in the PGA, accordingly all the Hub revenues (i.e., even what Nicor labels as "non-PGA Hub revenues") must offset the PGA costs. If the Commission disagrees with Staff's primary argument that all Hub revenues should be credited to the PGA, Staff argues in the alternative that the Company failed to show that Staff's \$8,209,614 adjustment for what the Company claims are "non-PGA revenues" are not subject to the general rule that Hub revenues were to offset PGA costs. Staff will not repeat the arguments previously made in its IB and RB in support of Dr. Rearden's first adjustment and therefore stands on the arguments previously made by Staff in those briefs, its brief on exceptions and Dr. Rearden's testimony.

B. Dr. Rearden's second adjustment – adjustment for increase in gas costs due to Company's use of storage

Dr. Rearden's second adjustment is based on the increase in PGA costs above Hub revenues caused by Nicor, when it imprudently loaned gas to Hub customers from the non-PGA Hub. Dr. Rearden's second adjustment is the increase in gas costs net of non-PGA Hub revenues. In total, Staff witness Dr. Rearden found that Nicor Gas' Hub services increased the reconciliation period's PGA costs by \$18,526,379. The second disallowance adjustment is \$10,316,765 (\$18,526,379 less \$8,209,614 (Dr. Rearden's first adjustment)). That is, the second adjustment represents the increase in gas costs above the revenues Nicor earned from providing Hub services. (Staff Ex. 4.0 (Public), 15: 311-320.)

Whether providing Hub services is prudent or not depends on the relative balance between the revenues earned for the services and the cost to supply those services. For instance, if on a forward-looking basis, the expected revenues generated by a loan of gas to a Hub customer are greater than the expected costs, then the transaction is not imprudent. This is true even if actual costs to support the service turn out to be higher and result in increased cost to the PGA. (Id. at 15:323-330.) Nicor assumed that all Hub loan transactions were costless. (Id. at 17:374.) Under Nicor's theory, any revenues from the loan transactions meant that ratepayers were better off with the loans than without them. (Id. at 17:374-377.) Consistent with this theory, Nicor claims that Hub services did not affect PGA gas costs. (Nicor Gas Ex. 7.0, 9: 182-183.) Through a data request, Staff asked Nicor how it decided whether a given transaction was prudent. In response, Nicor provided internal communications about the Hub that did not analyze individual transactions for whether the transaction revenues exceeded cost. As noted above, Nicor simply assumed that all Hub loans were prudent, since Nicor assumed that the loans were costless. (Staff Ex. 4.0 (Public), 15:331-16:344.) Because Nicor did not attempt to balance the expected value of the loan against the revenue generated by the loan, Nicor operated the Hub in complete disregard as to whether the transactions were prudent.

An analysis of that decision is consistent with the PUA and the prudence standard. As the Appellate Court stated in a Commonwealth Edison Company fuel adjustment clause reconciliation proceeding "[i]f, in a fuel reconciliation proceeding, the Commission could not examine the reasons that necessitated a fuel purchase, the prudence standard would have no effect on ensuring a just and reasonable rate" as is required by the Act. (Business & Professional People for the Public Interest, 171 Ill. App. 3d 948, 958 (1st Dist. 1988)). Simply put, Nicor failed to meet its burden of proof. Nicor has not

demonstrated that its Hub activities during 2003 were in fact prudent when it entered into each individual transaction. (*Id.*, 14:288:289.)

After Staff determined that Nicor failed to conduct a prudence analysis of its Hub transactions, Staff calculated an adjustment. Staff's adjustment calculation notes that when Nicor loaned gas to third parties, it was not delivering that gas to its retail customers. The gas loaned thus imposes costs on the PGA. Staff's adjustment (as shown in Staff Exhibit 4.0, Schedule 4.1 (Confidential)) compares the value of the gas that is loaned each day to Hub customers (as measured by the market price for gas on each particular day) to the value of the gas repaid by the Hub borrower (again measured by the market price for gas on each particular day) until the Hub balance returns to zero. The calculation is cumulative. For example, if on February 10, 2003 the Hub loans out 50,000 mmBtu⁶ when the Gas Daily price equals \$8, then the value of the loan to the borrower increases by \$400,000. On the other hand, as the loans get repaid by the borrower, the loan balance decreases. For example, if on March 17, 2003 the Hub balance decreases by 75,000 and the Gas Daily price is \$5, then the loan balance decreases by \$375,000 (\$5 times 75,000). Thus Staff's method calculates the difference between the value of the gas loaned to the borrower and the gas repaid by the borrower. In total, the gas volumes for the 2003 loans were \$18,526,379 more valuable than the gas that was repaid. (*Id.* at 18:385-391.) In total Nicor Gas loaned gas to borrowers that was expensive and was repaid with gas by the borrowers that was cheaper. (*Id.* at 18:382-383.) Accordingly, after taking into account Dr. Rearden's first Adjustment, Nicor Gas' imprudent use of gas

⁶ mmBtu stands for one million British thermal units.

storage caused PGA costs to increase by \$10,316,765. (Id. at 15:312:320.) (\$18,526,379 - \$8,209,614 = \$10,316,765.)

As CUB pointed out in its application for rehearing, the Commission's September 16, 2015 order is wrong when it states that CUB-AG and Staff's adjustments are based on hindsight. (Nicor Gas, ICC Order Docket No. 03-0703, 24 (September 16, 2015).) It is not illegal hindsight to use the market price for gas to calculate the adjustment which results from an imprudent decision. (CUB-AG Application for Rehearing, 6.) The principal of hindsight only comes into consideration when making the original determination of whether or not a judgment was prudently made. Accordingly, the imprudent decision, which hindsight cannot be used in assessing, was the decision by Nicor that there was no cost for the Hub transactions. Staff simply used the same facts that were available to the Company at the time it made its decision, to determine whether the Nicor decision was imprudent. As discussed above, when Nicor concluded that Hub transactions had no cost, Nicor refrained from performing any analysis of the expected revenue from its Hub transactions compared to the expected cost of each transaction. That decision by Nicor ultimately results in Nicor being unable to meet its burden of showing that the Hub transactions were prudent.

C. Recommended reconciliation and Factor O

As set forth in Staff's IB, the Commission should adopt Staff's recommended reconciliation and related Factor O for the 2003 reconciliation. The Commission should accept the reconciliation of revenues collected under the purchased gas adjustment clause with actual costs as reflected on Staff Exhibit 3.0, Schedule 3.01, Column (d), as set forth in Appendix A to Staff's IB.

Further, consistent with Staff's IB, the Commission should direct Nicor Gas to refund the Factor O amount of \$18,476,028 in the first monthly PGA filing after the final order on rehearing in this proceeding is entered, including any accrued interest from December 31, 2003 to the date of the order on rehearing, using the interest rate applicable to each year from 2004 through the year in which a final order on rehearing is entered.

III. CONCLUSION

Staff respectfully requests that the Illinois Commerce Commission approve Staff's recommendations in this docket.

Respectfully submitted,

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January 11, 2016

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